

Year-End Trade Deals Offer Hope for U.S. Business in 2020

by Dave Townsend and T. Augustine Lo

December 2019 has yielded some potentially significant relief to U.S. businesses and agricultural producers that may improve the terms of trade in 2020 after a prolonged period of increasing and damaging friction in U.S.-China and North American trade since 2018.

On December 13, the White House and China announced a “Phase One” agreement that pauses and rolls back some of the previously announced tariffs on U.S. imports of Chinese-origin products in exchange for Chinese purchases of U.S. products and yet-to-be-confirmed Chinese commitments pertaining to intellectual property (“IP”) rights, technology transfers, and dispute resolution. The Phase One deal is the first step in what is labeled as a multi-phase agreement with far-reaching changes envisioned in Phase Two and perhaps in subsequent further agreements.

Separately, on December 19, the U.S. House of Representatives approved with overwhelming bipartisan support the U.S.-Mexico-Canada Agreement (“USMCA”) that will replace and update the North American Free Trade Agreement (“NAFTA”). The USMCA appears almost certain to pass the U.S. Senate, which should ensure the USMCA comes into force among the United States, Mexico, and Canada in 2020, with only Canada’s legislative approval needed to make the agreement fully binding among the three USMCA countries.

These two major developments are cause for some cautious hope among many U.S. companies and farm producers who do business with China, Canada and Mexico. Nonetheless, as explained below, significant risks of further trade and investment barriers remain in 2020. Notably, some companies have expressed reservations about last-minute compromises in the USMCA text that were added to facilitate needed Congressional approval, and there will be close attention paid to the actual text of the Phase One agreement between the U.S. and China. However, that text will likely not be released until after it has been signed by President Trump and President Xi sometime in early January.

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U.S.-China Phase One Agreement

On December 13, 2019, the Office of the United States Trade Representative (“USTR”) announced that China and the United States had agreed on certain details of Phase One of a U.S.-China Agreement. Many specifics of the Phase One agreement remain unclear, but the U.S. has already suspended the List 4B tariff increases that were scheduled to go into effect on December 15, 2019, and has said it will cut in half the List 4A tariffs that had already gone into effect as of September 1, 2019.

The one clear detail of Phase One is that the United States agreed to tariff relief for U.S. importers of certain Chinese-origin products. USTR to date has imposed tariffs on Chinese goods in four lists under Section 301 of the Trade Act of 1974 (“Section 301”). Import tariffs of 25% on Chinese goods have already come into effect under Lists 1, 2, and 3 covering approximately US\$250 billion in annual imports from China, subject to individual exclusions obtained by U.S. importers. Phase One will not reduce or change any of the Section 301 tariffs on goods covered by Lists 1, 2, and 3.

List 4A, which applies to US\$120 billion of food, apparel, metal articles, sporting goods, and other consumer goods, took effect on September 1, subjecting those U.S. imports to a 15% tariff. List 4B, which covers another US\$160 billion of annual U.S. imports, was originally set to come into effect on December 15 and would have affected most remaining Chinese-made items that were not yet subject to the earlier Section 301 tariffs, including many consumer electronics products. Now, under Phase One, USTR published a Federal Register notice on December 18 to suspend all of the 15% List 4B tariffs indefinitely, while promising another imminent notice that will reduce by one-half the List 4A tariffs from 15% to 7.5%.

Phase One reportedly will include a set of Chinese commitments to purchase more U.S.-origin exports, including both agricultural and manufactured products, although the details of these purchase are still not public. In addition, China also reportedly agreed to commitments relating to IP, technology transfers, and non-tariff barriers to agricultural goods, although those commitments have also not yet been explained in any significant detail publicly. Accordingly, it is uncertain whether China has agreed in Phase One to significant changes with binding effect or if Phase One will merely be aspirational, a kind of “agreement to agree,” with all the hard and critical details yet to be negotiated in Phase Two. The only sure thing at the moment is that President Trump has delayed indefinitely the List 4B tariffs and promises to reduce the List 4A tariffs by one-half.

President Trump claims that China has agreed to purchase US\$50 billion per year in U.S. agricultural goods over the next year and more than US\$200 billion total over two years, with similar purchases following that. However, significantly, China has not confirmed these kinds of figures (or any figures at all, to date). Moreover, it is not clear on what terms these export purchases would be made or if they will only be subject to market conditions. In short, although these purchases might turn out to be significant, the parties have yet to fully describe to the U.S. business community exactly how and when they will be completed. China has also already begun lowering tariffs on imports of several hundred categories of goods from all countries into China, including for

agricultural products, as an apparent pathway toward such purchases from the United States under Phase One. However, because such Chinese tariff relief does not favor only U.S. goods but will benefit all global suppliers to China, the net beneficial effect on U.S. companies and U.S. farmers may be less than some might wish.

The Administration began imposing tariffs on Chinese-origin goods in mid-2018 because the USTR had determined in March 2018 under Section 301 that China's alleged policies and practices relating to technology transfers from the United States to China impede U.S. commerce. USTR has thus vowed to continue imposing tariffs against Chinese exports until China agrees to fundamental changes in how it treats American IP and technology, and China has vowed with equal fervor not to be bullied by the U.S. and so has imposed a wide range of counter-tariffs on U.S.-origin goods, especially against American agricultural products. Phase One indicates that both sides now appear inclined to seek an "off-ramp" to the U.S.-China trade dispute. USTR has announced it will immediately seek to begin working with China on Phase Two, but the incentives and abilities for both sides to reach a Phase Two agreement during 2020 may be reduced by the Presidential election.

Finally, Phase One probably needs to be considered in the broader context of U.S.-China relations, which reflects a growing strategic wariness on both sides. With the backing of a Congressional legislative mandate in 2018, the White House appears intent on imposing more and increasingly rigorous "national security" reviews on most Chinese direct investments in the U.S. under the Committee on Foreign Investment in the United States ("CFIUS"), giving new access control powers to the U.S. Department of Commerce and the Federal Communications Commission to exclude Chinese telecommunications equipment and technology (especially 5G technology), expanding U.S. export controls to limit and cut back on U.S. technology transfers to China, and creating new immigration visa barriers that will probably reduce the number of Chinese nationals allowed to study or work in the United States. In addition, the U.S. Department of Defense has announced it will increasingly seek to shift the focus of its military planning and commitments from the Middle East to Russia and China as the major strategic threats against U.S. interests in the foreseeable future.

For its own part, the Chinese government has also reacted with its own reassessment of how much China should continue to rely on U.S. inputs and investment for key segments of its economy, especially in the areas of advanced technologies. To the extent that U.S. policies now appear to Chinese leaders as handicapping or limiting China's future economic or technological advancement, those leaders in Beijing are probably more apt to direct procurement decisions toward non-U.S. providers and also to invest more heavily in domestic Chinese alternatives to insulate China from such U.S.-directed constraints. Thus, when all these conflicting U.S. and Chinese government policies are viewed as a whole, the net effect of Phase One on the overall business outlook for U.S.-China trade and investment is likely to be tempered.

USMCA

After President Trump threatened to unilaterally withdraw the United States from NAFTA,

which he had repeatedly called “the worst trade deal in history” for the U.S., USTR negotiated USMCA with the governments of Canada and Mexico. The original version of USMCA was formally signed by the three nations in November 2018. However, to enhance the chances for U.S. Congressional approval, trade negotiators from the three countries agreed to certain key amendments to the original version on December 10 that would reduce patent protection for new pharmaceutical products, enhance scrutiny of Mexican labor conditions, increase enforcement of environmental protection laws, and strengthen the USMCA dispute settlement procedures. (These last changes have caused at least one industry-led lobbying group, “Pass USMCA,” to retract its earlier support for USMCA, citing the reduced protection for pharmaceutical patents.) Confirming the importance of these final adjustments to USMCA, with strong union support, the U.S. House of Representatives approved the amended version by a vote of 385 to 41, and the U.S. Senate is expected to approve USMCA early in 2020 once it has dealt with the impending impeachment trial for the President. The almost certain passage of USMCA is thus a very welcome relief for U.S. businesses because it significantly reduces the possible disruption of cross-border trade due to NAFTA becoming inapplicable.

In certain respects, USMCA provides critical updates and changes that may significantly affect individual businesses or sectors, although overall the agreement mostly preserves the status quo under NAFTA. We highlight areas below where USMCA differs significantly from or adds to NAFTA. Several of the changes made through USMCA revolve around the principle of “national treatment,” which is a rule in international law that, if a nation offers specific rights, benefits or privileges to its own citizens, then it must also give those same rights, benefits or privileges to foreign citizens when they are operating in that nation. In the realm of international trade, the principle of “national treatment” generally means that imported and domestically produced goods should be regulated or taxed on an equal and non-discriminatory basis once the imported items have entered a given national market.

- **Digital Trade.** USMCA adds a new chapter of provisions to govern cross-border digital trade, which USTR has insisted includes state-of-the-art standards that should be adopted in all future trade agreements or included in updates to existing trade agreements that lacked such provisions. The digital trade chapter bans customs duties on sales of products distributed electronically, limits government restrictions on data storage and transfer, ensures suppliers can rely on electronic authentication and signatures, prevents certain required disclosures of proprietary source code, promotes open access to government-generated data, and limits the liability of internet platforms for third-party content that the platform hosts. (House Speaker Nancy Pelosi opposed the liability limitation, but that provision remained in the USMCA passed by the House.)
- **Environment.** USMCA has new and specific provisions relating to trafficking in wildlife and timber and to law enforcement of environmental standards for air quality and marine pollution.
- **Intellectual Property.** USMCA adds a lengthy new IP chapter that updates and enlarges existing IP protections in NAFTA. The IP chapter requires so-called “national treatment” for copyrights and certain related rights, provides specific protection for pharmaceutical and agricultural inventions, and will require a minimum copyright term of the author’s life plus 70 years and, for a work unrelated to the term of life of an

individual author, 75 years after its first authorized publication. (Canada currently only offers a protection term of the author's life plus 50 years, so this change will require some Canadian legislation.) The new chapter will also require adoption of new standards to prevent the evasion of technological protection of electronic works and ensures various standard enforcement measures will be available for IP protection.

- **Financial Services.** USMCA includes "national treatment" and "most favored nation treatment" for U.S. financial services suppliers, requires market access for certain financial services, and prevents local data storage requirements where a financial regulator has access to necessary data.
- **Labor.** USMCA includes labor-friendly provisions relating to collective bargaining, recognition of international labor rights, a new labor content value rule for certain automotive products, and dispute settlement mechanism for increased monitoring and enforcement of labor rights.
- **Product-Specific Rules of Origin.** USMCA revises many of the NAFTA rules of origin that will have to be met to receive USMCA's preferential tariff rates. In particular, USMCA will change many of the automobile rules of origin by requiring a higher percentage of North American content and that such North American content must be produced by laborers who are paid at a specified hourly wage rate or higher to qualify for the preferential tariff rates.

Overall, however, the USMCA largely preserves the status quo created under NAFTA, ensuring that the terms of trade among USMCA countries remain effectively the same as they have been for the past 25 years. The United States International Trade Commission ("ITC") estimated in early 2019 that the benefits from USMCA are modest, with only a 0.35 percent increase in U.S. economic output and 0.12 percent increase in U.S. employment by the sixth year following its enactment. Although these numbers do not include changes to USMCA that were recently made as a result of USTR's negotiations with the U.S. Congress, it seems unlikely that the ITC's economic impact analysis would materially differ as a result of the more recent changes to USMCA.

Accordingly, USMCA preserves most elements of the existing NAFTA that have served all three nations well for a quarter-century since coming into effect on January 1, 1994. Under NAFTA, Canada and Mexico became the two major trading partners of the United States, and thousands of complex supply chains now extend across the U.S. northern and southern borders, supporting, directly and indirectly, millions of jobs in all three nations.

One point of caution, however, is that President Trump threatened to impose punitive tariffs against goods from Mexico in mid-2019 based on Mexico's alleged failure to stem illegal Central American immigration into the United States. Given the prominence of immigration and "border control" as major concerns of the White House, it remains possible that this immigration issue could flare up again against Mexico based on President Trump's immigration goals even after USMCA comes into force.

Ironically, the United States, Mexico, and Canada were all parties to the Trans-Pacific Partnership ("TPP") negotiations that covered much the same ground and even more and that would have helped to set the rules for decades covering roughly 40% of the world's total trade. Although USTR has noted that much of the TPP gains have been approved with respect to Japan in the U.S.-Japan free trade agreement, the broader TPP

would have created a U.S.-led multilateral trade regime that would have exerted tremendous influence across the entire Asia-Pacific region and elsewhere in the world. In abandoning the TPP, the U.S. effectively walked away from eight years of difficult and politically costly trade negotiations with several of America's major trading partners and then added three more years of efforts at USMCA to bring about only a small fraction of the tariff reductions and removal of non-tariff barriers facing U.S. businesses in foreign markets that might have been possible under the TPP. The lost trade opportunities and, perhaps even more critically, the lost geopolitical and strategic opportunities for the U.S. in its abandonment of TPP may never be recovered, even with the final approval of USMCA that is likely to occur in early 2020.

Dorsey's attorneys at its offices in the United States, China, Canada, and United Kingdom can assist companies with assessing the potential impact of the trade matters discussed above. For additional information, please feel free to contact the attorneys listed, or see Dorsey's website, at www.dorsey.com.